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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

110-118 RIVERSIDE TENANTS CORPORATION,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

BRIEF AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

STUART M. SAFT
WOLF HALDENSTEIN ADLER FREEMAN & HERZ
A member of the Bar of the Supreme Court. Counsel of Record for the Council of New York Cooperatives, National Cooperative Business Association, Federation of New York Housing Cooperatives, Apartment Owners Association, and the Real Estate Board of New York.
270 Madison Avenue
New York, New York 10016
(212) 545-4600

TERRY LEWIS
A member of the Bar of the Supreme Court and President and Counsel of Record for the National Association of Housing Cooperatives, Petitioner.
440 Marion Street
Ypsilanti, Michigan 48197
(313) 487-5210

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Statement of Interest

This brief is submitted on behalf of the Council of New York Cooperatives (CNYC), a New York corporation that represents the interests of over 1250 cooperatives (comprising over 115,000 cooperative dwelling units) located in the New York metropolitan area. CNYC is joined in its submission by the following organizations: the National Association of Housing Cooperatives (NAHC), a Delaware not-for-profit corporation that represents the interests of housing cooperatives and professionals across the United States; the National Cooperative Business

Association (NCBA), a District of Columbia not-for-profit corporation which serves as the national trade organization for America's cooperative business community (including the housing, agriculture, banking, utility, and other consumer and producer sectors); the Federation of New York Housing Cooperatives (FNYHC), another New York not-for-profit corporation representing an additional 120,000 units of cooperative housing in the New York City area; the Apartment Owners Association, Inc., a New York corporation for owners and managers of residential apartment buildings in New York City, and the Real

Estate Board of New York, the trade association of New York's real estate industry.

This brief is submitted in support of the petition for a Writ of Certiorari on behalf of 110-118 Riverside Tenants Corp., a member of both CNYC and NAHC. Its purpose is to call to the Court's attention significant additional considerations and grave consequences of the decision of the Court below upon other co-operatives and their shareholders, not parties to this action, which were not addressed by the Court below.

Because this appeal concerns the nature of property rights represented by a cooperative's shares, and the net of obligations between a cooperative and its shareholders, it is of vital concern not only to the many housing cooperatives in the State of New York, but potentially to every housing cooperative in America and every non-housing cooperative whose shares are burdened with obligations of payment by the shareholder to the cooperative arising from the shareholder's use of the cooperatives assets and/or services. The cooperatives potentially affected, taken

together, constitute a significant share of the nation's economy.

CNYC has received the consent of both parties to file this brief.

REASONS FOR GRANTING THE WRIT

I. THE COURT SHOULD REVIEW THIS CASE BECAUSE IT CONCERNS A MATTER OF SUBSTANTIAL PUBLIC IMPORTANCE

Due to the very nature of cooperative housing, the decision of the Court below presages grave financial consequences to innocent homeowners and other cooperative shareholders in both New York and across this nation.

A cooperative housing corporation is one in which the corporation provides dwelling space to its shareholders at or near cost. The cooperative corporation owns residential real property, and its shareholders have the exclusive right to occupy units or apartments - for which the shareholders pay their proportionate share of the corporation's expenses in owning and operating the property by making monthly payments (called variously rent, occupancy, or maintenance charges).

Due to the fact that each shareholder pays a portion of the expenses, the failure of any

shareholder to make maintenance payment creates serious financial problems for the balance of the shareholders. It is for this reason that the Board of Directors of a residential cooperative has a broad authority to act in the event of a default by a shareholder. Moreover, the proprietary lease provides that the shares of the corporation cannot be sold unless all funds owed to the corporation are paid in full, including the cost of collecting arrearages.

Inherent in the definition of a housing cooperative is that the corporation provides dwelling space to its shareholders at cost, and

that ownership of shares in a co-operative entitles the shareholder to the use of the corporation's assets or services. Housing cooperatives generally do not pay any return on a shareholders' invested capital, and it is axiomatic of a cooperative that investment is for the purpose of acquiring the right to a home, rather than for the purpose of earning income.

In every instance, the rights of use are subject to an agreement. In the case of a housing cooperative, this agreement is called the occupancy agreement, otherwise known as a proprietary

lease. As in Petitioner's case, the proprietary lease typically provides the cooperative the right, upon default in payment of occupancy charges, to retake possession of the unit and to sell the shares, distributing the net proceeds, if any, to the evicted former shareholder.

Thus, in an ongoing cooperative, the property conferred by ownership of the shares is only the right of use subject to the agreement. The value of the shares is the value of the perpetual right of occupancy subject to the lease, i.e. the net proceeds on sale.

This is precisely what is meant by the "inseparability" of the proprietary lease and the shares, a concept accepted under New York state law,[1] which was recognized but eviscerated by the Court below.

A housing cooperative is very different from a condominium. In a

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[1] The Court below refers to Grenader v. Spitz, 537 F. 2d 612 (2d Cir.), cert. denied, 429 U.S. 1009 (1976); Malkin v. United States Dep't of Treasury - I.R.S., 645 F. Supp. 229, 231 (S.D.N.Y. 1986); In re Matter of Carmer, 71 N.Y. 2d 781, 525 N.E. 2d 734, 530 N.Y.S. 2d 88 (1988); and State Tax Comm'n v. Shor, 43 N.Y. 2d 151, 371 N.E. 2d 523, 400 N.Y.S. 2d 805 (1977).

condominium, each unit owner owns a fee simple interest in their individual units and pays his or her own mortgage debt services and real estate taxes. In a housing cooperative, however, taxes are assessed on, and a mortgage secured by, the entire multi-family property. If these are not paid, the municipality or the mortgagee can foreclose on the property and take the homes and financial investments of all of the shareholders. Even shareholders who are current in their maintenance payments risk the loss of their homes if they are unable to cover a defaulting shareholder's payments. The pass-through of

these charges on a proportionate basis to the individual shareholders of a housing cooperative in the form of maintenance charges is the essence of the cooperative form of ownership.[2]

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[2] It should be noted in passing that Internal Revenue Code Section 216 provides the pass-through nature of these charges by allowing the shareholder (rather than the Corporation) to take mortgage interest and real estate tax deductions on their individual income tax returns, and that the definition of a cooperative housing corporation recognizes the unity of shares and proprietary lease in the requirement that the value of the individual shareholder's shares bears "a reasonable

It is this need of cooperative shareholders to rely on each other for joint financial obligations that necessitates Boards of Directors to ascertain that purchasers of shares have the financial ability to make their maintenance payments and to strictly enforce the terms of corporation's governing documents, including its by-laws, and the standard form of proprietary lease

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relationship to the portion of the value of the corporation's equity which such person is entitled to occupy." (Emphasis Added).

that it executes with each of its tenant/shareholders.

The justification for the powerful remedy for default under the lease -- and the consequent limitation of the property interest of the tenant/shareholder -- is that non-payment of occupancy charges by one tenant/shareholder compromises the corporation's ownership of the property (through mortgage and/or property tax default and foreclosure), and thus jeopardizes the home-ownership of each family in the building.

The peril is best illustrated by the case of a 2 unit

cooperative. If one of the two families defaults, the second family must double the debt-service and property tax portions of its occupancy charges, along with an irreducible minimum of ongoing operating costs, virtually doubling the amount it must pay to keep its home. That innocent family would be required to make the increased payments to the cooperative. Under the terms of the proprietary lease, the cooperative may institute summary eviction proceedings, re-sell the unit, recoup the losses out of the proceeds of the sale, and repay the innocent family.

The Court below has held that despite the clear terms of the proprietary lease, the innocent family cannot be repaid for the sums that it has expended in maintaining the jointly owned property. Effectively, the Court has given that family the choice of (a) losing its home, or (b) virtually doubling its housing costs for some unknown period with no possibility of recoupment.

The fact that most cooperatives have more than two units may lessen the burden to the individual innocent shareholders, but does nothing to lessen the injustice.

Moreover, if 110-118 Riverside Drive were a two unit cooperative, the government's lethargy in exercising its rights would probably have resulted in the inability of the other shareholder to pay all of the costs of the property, resulting in a foreclosure of the mortgage and real estate taxes and the loss of any chance for the government to be paid Broady's unpaid income taxes. Obviously, as Broady's unpaid taxes dated back to 1951-1954, it was only through the efforts of the Cooperative that the government received any funds at all, much

less the $810,000 that has already been paid to it.

NAHC has calculated that there are as many as one million individual units of cooperative housing scattered across the nation, with about half of them located in the New York City area. CNYC and FNYHC combined represent over 1650 cooperative corporations with over 200,000 shareholding families. Many homeowners have been imperiled by the decision in this case.

This decision will not only have adverse consequences on New York housing cooperatives with

respect to federal tax liens, but will probably also have adverse consequence with respect to state law creditors of defaulted tenant/shareholders, who will assert, citing the holding of the Court below, that state law provides that they have priority over the claims of the cooperative... although no case or statute supports that proposition.

Moreover, the decision will probably have a "spill back" effect on the law of New York and other states both with respect to housing cooperatives, and with respect to other cooperatives whose inseparable shares and use

agreements allow similar remedial action by the cooperative when a shareholder defaults.

Moveover, in the state of New York, there have been recent defaults in the payment of occupancy charges by sponsors of partially converted cooperatives, who, as a result of New York's "non-eviction" conversion process, may continue to hold from ten to eighty percent of these cooperatives' shares.[3]

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[3] See, The New York Times, January 21, 1990, Section 10, p. 7, col. 1; February 4, 1990, Section 10, p.1, col. 2; Crain's New York Business, January 22, 1990, p. 3, col. 4.

Recent weakness over the past two years in the resale market for all residential real estate in the Northeast area, including cooperatives, has created liquidity problems for investors in occupied cooperatives. As a financial newspaper has reported:

> New York's residential cooperative market is heading into a crisis that could bankrupt dozens of building sponsors and threaten the equity of thousands of coop owners.
>
> The turmoil, at best, is expected to last two years and could further depress coop prices by dumping distressed units on the market.[4]

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[4] Crain's New York Business, January 15, 1990, p.1, col. 3.

Accordingly, there are a large number of existing defaults by apartment owners and the potential for many more defaults,[5] in the New York area, the problems created by the decision of the Court below burden a substantial number of innocent families in New York and elsewhere, making this case a matter of substantial public importance.

II. THE COURT SHOULD REVIEW THIS CASE BECAUSE IT IS GOVERNED BY, AND HAS BEEN DECIDED CONTRARY TO, STATE LAW

The major defect in the decision below is that although

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[5] See, Crain's New York Business, January 29, 1990, p.8.

both the Circuit Court (A-17)[6] and the District Court (A-40) held that the rights of the taxpayer are determined by state law, neither the Circuit Court nor the District Court specifically analyzed New York law to determine whether in fact the lease obligations are an incident of, and limitation on ownership, of cooperative shares, or are instead treated as a "lien."

The Circuit Court affirmed the District Court in finding that the rights conferred on the cooperative by its proprietary lease were

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[6] References are to the Appendix to the Petition for Certiorari in this case.

security interests on the obligations of the lessee. The necessary foundation for the District Court's finding was its holding that the shares and the lease could be analyzed as legally separate documents.

The Circuit Court, referring to state law,[7] held that "the shares of stock and the lease are inseparable and must be treated as a unit." (A-12)

This holding necessarily destroyed the intellectual and legal underpinning of the District

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[7] See footnote 2 above.

Court's decision. As the Circuit Court noted, it then became necessary under Aquilino v. United States, 363 U.S. 509 (1960), to refer to state law to determine whether the interest of the cooperative is a "secured interest in the nature of a lien".

This it did not do.

Rather than examine state law, the Court turned to a conflicting Seventh Circuit case,[8] and attempted to distinguish it on the basis of the Seventh Circuit's

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[8] Chicago Mercantile Exchange v. United States, 841 F.2d 1352 (7th Cir. 1988).

footnote regarding debts among members of a condominium - debts unrelated to either the condominium corporation itself or to the ownership/occupancy rights in a dwelling unit, and thus totally irrelevant to this case. Moreover, as will be discussed, that case clearly supports the Cooperative.

State law is the basis for the Circuit Court's determination that "[u]nlike the common understanding of the term "stock," the shares of "stock" in the Apartment Corporation are not freely transferable, and have no value

independent of the Lease for the Apartment[9].

As set forth above, the simple meaning of the inseparability of lease and shares, under state law, renders the decision below incorrect. If there was or is any doubt on this, the court below should have certified the issue to the New York Court of Appeals.[10]

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[9] A-11; For the Court's citations, see footnote 2 above.

[10] See Rules of the Second Circuit Section 0.27, Rules of the Court of Appeals Section 500.17 (Certification of Question of State Law).

In Belton v. Hatch, 109 N.Y. 596 (1888), the highest court of the State of New York held that a creditor is bound by limitations on property rights contained in the by-laws of a stock exchange. The cases cited by the Court below regarding the unity of lease and shares indicate that this principle applies to cooperatives. Nothing in New York law raises is even remotely to the contrary.

III. THE COURT SHOULD REVIEW THIS CASE BECAUSE THE GOVERNMENT'S FAILURE TO PAY MAINTENANCE AFTER MARCH 1985 WAS A TAKING WITHOUT COMPENSATION IN VIOLATION OF THE FIFTH AMENDMENT TO THE UNITED STATES CONSTITUTION

The Fifth Amendment to the United States Constitution bars the

taking of private property for public use without just compensation. However, the lower Courts have ignored the fact that this case involves an attempt by the Government to require the corporation to pay the maintenance costs of the Government's shares after the entering of the judgment of foreclosure.

The undisputed facts of this case are that Broady, who failed to pay income taxes between 1951 and 1954, acquired shares in the cooperative in 1968 and paid his maintenance until 1985, when the Government moved to foreclose its liens on Broady's shares and

obtained a judgment of foreclosure against him. Until March, 1985, when the Government obtained its judgment, Broady paid his maintenance. He then vacated the apartment. Accordingly, the critical question that the lower Courts failed to answer is, "who owned the shares after March, 1985?" Alternatively, "what is the effect of the Government's obtaining a judgment of foreclosure?"

Certainly, once the judgement of foreclosure was obtained by the Government, Broady no longer had (a) any right to the shares of the corporation, or (b) the right to

occupy the apartment. In fact, Broady vacated the apartment immediately after the judgment of foreclosure was entered. It was in March, 1985, that the Government acceded to Broady's rights to the shares and the apartment. Accordingly, it was in March, 1985, when the Government should have begun paying maintenance to the corporation in order to preserve the asset that the Government obtained by foreclosing its tax lien.

The Government then ignored its obligations to pay maintenance to the corporation, which was required in order to defray the

corporation's expenses in safeguarding the value of this asset and, when the Government refused pay the maintenance or to sell the shares to someone who would pay the maintenance, the corporation acted and sold the apartment.

A careful review of the Internal Revenue Code, in general, and the Federal Tax Lien section, in particular, provides no limitation on the Government's obligation to pay carrying charges for assets it seizes in payment of tax liens. At the very least, if the corporation is unable to recover its maintenance for the

period prior to the sale, then the Government has been unjustly enriched at the expense of the corporation's other shareholders.

VI. THIS COURT SHOULD REVIEW THIS CASE BECAUSE THE SECOND CIRCUIT AND THE SEVENTH CIRCUIT HAVE ISSUED CONTRADICTORY DECISIONS ON THE SAME ISSUE

In Chicago Mercantile Exchange v. United States, 840 F. 2d 1352, 1356 (7th Cir. 1988), a case involving the right of a commodities firm to retain from the proceeds of the sale of a seat on the exchange any amounts owed by a taxpayer to the exchange even though the taxpayer was not in default to the exchange when a

Federal Tax Lien was filed, the Seventh Circuit held that "the rules of the exchange create the property and they govern its attributes."

The basis of the Chicago Mercantile decisions was that the taxpayer purchased his seat on the exchange subject to the rules of the exchange and could not sell that seat without complying with the exchange's detailed rules and reimbursing the exchange for amounts owed to the exchange prior to sale. Likewise, in the instant case, Broady acquired his shares in the cooperative corporation with the knowledge that there were

detailed rules as to his ownership of the shares and the use of the apartment, that he would not be able to sell the shares without the approval of the cooperative corporation, and that any money owed by Broady to the cooperative had to be paid prior to the Board of Director's approving a sale. There is no difference between these two cases. However, the Second Circuit dismissed the similarity by holding simply that "shares of stock in a cooperative corporation are not the same as memberships in an exchange," (A-21) Moreover, by stating in a footnote that a Chicago Mercantile

lends credibility to its decision. (A-19).

Nevertheless, not only did the Government attempt unsuccessfully to make the same arguments in Chicago Mercantile as it makes in this case, but the Seventh Circuit specifically denied it. In a striking similarity to the instant case, the Seventh Circuit also noted that, "the rule was an incident of the seat when Yermack bought the membership; it pre-existed his interest and will survive so long as the seat exists. It is an incident of the property, not a lien on that property". 840 F. 2d at 1357.

It certainly appears that the foregoing language is as applicable to the instant case as it was in Chicago Mercantile.

Moreover, footnote 7 in Chicago Mercantile to which the Second Circuit refers, is totally irrelevant as the reference is to a condominium unit, which is a separate fee interest in real estate, rather than an interest in a cooperative, which is stock in a corporation. By definition, a cooperative has far more binding obligations placed on its shareholders than condominium unit owners. Moreover, the hypothetical

contained in footnote 7 concerns possible conditions of the condominium that could defeat the intent of Federal Tax Liens by providing that no unit owner could sell a unit without repaying money owed to other unit owners. The hypothetical bears no resemblance to this situation, where, by state law, the cooperative shares could not be sold without payment of unpaid maintenance.

As the Seventh Circuit states in Chicago Mercantile, at 840 F. 2d 1358,

> "If Congress wished the statute to reach property not 'belonging to' the taxpayer, it could have

worded the statute to achieve that result."

V. THE COURT SHOULD REVIEW THIS CASE BECAUSE IT IS CONTRARY TO PRIOR DECISIONS OF THIS COURT

The lower court equated the instant case with United States v. Equitable Life Assurance Society, 384 U.S. 323 (1966), as obviating the need by the Government to pay maintenance. In Equitable Life, the holder of a mortgage, which was granted priority over a Federal Tax Lien that was filed before the mortgage was in default, unsuccessfully attempted to have its legal fees included within the priority of its mortgage.

However, the lower court in the instant case incorrectly equated the unpaid maintenance with the attorney's fees in Equitable Life. It is true that the attorney's fees fail to satisfy the Doctrine of Choateness, because at the time the Federal Tax Lien was filed the identity of the lienor and the amount of the lien had not been established. However, the unpaid maintenance in this case is more akin (although on demonstrably stronger equitable grounds) to the interest that accrued on the mortgage after the Federal Tax Lien was filed. Like the interest payable to Equitable Life, the Government knew when it filed its

Tax Lien that the maintenance would accrue to the corporation and the amount was clearly ascertainable since the maintenance was a fixed sum each month (much like the interest which was the principal multiplied by the interest rate and the amount of time it was unpaid.)

It is obvious that the lower court erroneously held that the Doctrine of Choateness required that the exact amount of the prior lien be ascertained in order for it to have priority, whereas it should be sufficient for a formula to exist so that the amount of the prior lien can be ascertained

although the actual amount fluctuates.

Finally, it must be pointed out that the unpaid maintenance, unlike either the principal or the interest on the prior mortgage, directly benefitted the Government. While the principal and the interest was paid to the mortgagee in Equitable Life and provided no benefit to the Government, in this case the Government received a direct and important benefit from the maintenance that was being advanced by the corporation -- it not only protected the asset but enabled the value of the shares to grow in value, so that it was

ultimately worth almost half of the Government's entire lien. A value that was probably 100% of the value of the shares when the Government filed its lien ten years earlier. There is no indication in Equitable Life or any of the other cases cited by the Government, that the Corporation has an obligation to subsidize the Government.

CONCLUSION

This case concerns a matter of substantial public importance and is inconsistent with a decision of the highest court of New York on a serious question of state law. Review of this case by this Court

will resolve a conflict between the Circuit Courts of Appeal, promoting consistency in decisions involving the disposition of property subject to a tax lien, and will constitute a proper and necessary exercise of the Court's power of supervision in order to promote compliance with the constitutional principles involved in this case.

For these reasons, the Council of New York Cooperatives, joined by the National Association of Housing Cooperatives, the National Cooperative Business Association, the Federation of New York Housing Cooperatives, the Apartment Owners Association, and the Real Estate

Board of New York, request that the petition for a writ of Certiorari to the United States Court of Appeals for the Second Circuit by 110-118 Riverside Tenants Corp. be granted.

Dated: April 24, 1990

Respectfully submitted,

STUART M. SAFT
WOLF HALDENSTEIN ADLER FREEMAN & HERZ
A member of the Bar of the Supreme Court,
Counsel of Record for the Council of New York Cooperatives, National Cooperative Business Association, Federation of New York Housing Cooperatives, Apartment Owners Association, and the Real Estate Board of New York.

270 Madison Avenue

New York, New York 10016
(212) 545-4600

TERRY LEWIS
A member of the Bar of
the Supreme Court and
President and Counsel of
Record for the
National Association of
Housing Cooperatives,
Petitioner.

440 Marion Street
Ypsilanti, Michigan 48197
(313) 487-5210